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Discussion of substantive issues related to international cooperation in tax matters: United Nations Model Tax Convention update

Country observations, reservations and positions: relevance to the United Nations Model Tax Convention

Note by the Secretariat**

I. Introduction

1. The issue of possibly having country observations, reservations and positions on the United Nations Model Double Taxation Convention between Developed and Developing Countries has become a significant one as the Committee of Experts on International Cooperation in Tax Matters comes closer to concluding its work on the 2011 update of the United Nations Model Convention. There are two aspects of the issue that should not be confused:

(a) The first aspect is whether, in extensively citing the Model Tax Convention on Income and on Capital of the Organization for Economic Cooperation and Development (OECD), the relevant observations and reservations of OECD member States and the positions of non-OECD member States should also be noted, in order to give a complete picture of views on a particular issue;

(b) The second aspect is whether the United Nations Model Convention should include, or be complemented by, country observations, reservations and positions on the Model Convention itself. The two aspects are distinct, although a State could, of course, take the same position in relation to both model conventions.

* E/C.18/2011/1.

** The present note is intended to assist the Committee of Experts in its deliberations and does not necessarily reflect the views of the Committee or of the United Nations.

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II. Observations, reservations and positions on citations from the Model Tax Convention on Income and on Capital of the Organization for Economic Cooperation and Development

2. The first aspect (see para. 1 (a) above) relates to a particular practice relative to the OECD Model Tax Convention whereby a reservation is made by an OECD member State with regard to provisions of the treaty that the State does not follow. However, it is understood that where the commentary to an article provides an alternative formulation to that of the article, and an OECD member State follows that formulation, it is not necessary to make a reservation.

3. An OECD member State makes an observation when it has no objections to the wording of the article but interprets it in a way that is different from the way it is interpreted in the commentary to the article. States usually indicate how their interpretation differs when making an observation. Observations and reservations are noted at the end of the commentary on each article. In addition, the OECD Model Tax Convention includes, in a separate part, at the end of the commentaries, the positions of those non-OECD member States that have chosen to comment on their approaches to the text of the instrument and the interpretations of that text.

4. The formal basis for the observations and reservations can be found in expectations of country conduct that flow from a 1997 recommendation of the OECD Council[1] that still applies to OECD members. In the recommendation, the Council:

> Recommends the Governments of member countries:
>
> 1. to pursue their efforts to conclude bilateral tax conventions on income and on capital with those member countries, and where appropriate with non-member countries, with which they have not yet entered into such conventions, and to revise those of the existing conventions that may no longer reflect present-day needs;
>
> 2. when concluding new bilateral conventions or revising existing bilateral conventions, to conform to the Model Tax Convention, as interpreted by the Commentaries thereon;
>
> 3. that their tax administrations follow the Commentaries on the Articles of the Model Tax Convention, as modified from time to time, when applying and interpreting the provisions of their bilateral tax conventions that are based on these Articles.
>
> II. Invites the Governments of member countries to continue to notify the Committee on Fiscal Affairs of their reservations on the Articles and observations on the Commentaries.
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> III. Instructs the Committee on Fiscal Affairs to continue its ongoing review of situations where the provisions set out in the Model Tax Convention or the Commentaries thereon may require modification in the light of experience gained by member countries, and to make appropriate proposals for periodic updates.

[1] OECD recommendation C (97)195/FINAL.

5. As the United Nations Model Convention cites the OECD Model Tax Convention extensively, the question has arisen of whether these observations, reservations and positions need to be referenced, for completeness, either generally or in specific cases. The Committee discussed the matter at some length at its third session, and noted the following (see E/2007/45, paras. 34 and 43):

> 34. The point was made by two countries that in citing (at proposed para. 73) paragraph 23 of the OECD Commentary on article 1 (addressing base companies through controlled foreign corporations (CFC) legislation), there must be some regard for the fact that they and other OECD countries had observations on that paragraph. It was noted that the issue of minority views had arisen in the context of permanent establishments, with note 2 of paper E/C.18/2007/CRP.3 suggesting an approach to dealing with this issue. The issue was considered by the Committee and it was decided that relevant country positions should be included in the Manual [for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries] rather than in the Commentaries themselves.
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> 43. It was noted that the subcommittee [on definition of permanent establishment] had proposed (at note 2) that there should be an annex to the United Nations Model Taxation Convention containing the relevant OECD member "observations" and non-OECD member "positions" on the OECD Commentaries cited in the United Nations Model Taxation Convention. The subcommittee proposed to include a note in the introduction to the United Nations Model Taxation Convention referring to the relevance of these observations and country positions. It was agreed that such an approach would be discussed when considering the issue of citation of the OECD Model. As noted at paragraph 31 above, the Committee ultimately decided that relevant country positions would be addressed in the Manual rather than in the Commentaries themselves.

6. The note referred to in the report of the Committee on its third session (E/C.18/2007/CRP.3, annex, footnote 2) reads:

> The subcommittee proposes that the next version of the United Nations Model should note in its introduction, words along the following lines: "In extensively quoting the Commentary to the OECD Model , it is noted that this has be to read together with the 'observations' of OECD Member countries to obtain a full understanding of the acceptance or otherwise of certain parts of the Commentary by specific OECD countries in particular cases. The observations on the most recent version of the OECD Model (2005) are included at Appendix** of this publication for convenience, along with relevant "positions" on the OECD Commentaries provided to the OECD by some non-members of the OECD". The subcommittee notes that such an introductory paragraph would render it unnecessary to include a special comment along the same lines in the Commentaries of the United Nations Model on each specific Article.

7. The OECD Model Tax Convention is more readily accessible to policymakers and administrators from developing countries now than it has been in the past, and the value of including all observations, reservations and positions to the OECD Model Tax Convention that are quoted in the United Nations Model Convention would seem to be heavily outweighed by the confusion that doing so could create

with regard to the differences between the United Nations and the OECD model conventions and with regard to the complexity of reading the United Nations Model Convention, especially in cases when quotations of the OECD Model Tax Convention do not come from the latest version of the treaty and when changes have been made to the observations, reservations and positions in the meantime. Including the observations, reservations and positions could also be viewed as denying the United Nations Model Convention its status as having a "life of its own" and as being unnecessarily driven by developments in the OECD Model Tax Convention.

8. If there was no provision for positions on the United Nations Model Convention, it could be questioned why special treatment should be given to positions on the OECD Model Tax Convention, with no opportunity given for comments to be made by States that had not commented on the OECD instrument. If, on the other hand, there was a provision for positions on the United Nations Model Convention, it could be questioned why there would remain a need to separately note positions on those parts of the OECD Model Tax Convention that were incorporated by reference into the United Nations Model Convention. This argument is strongest for cases where it is clear that the commentary on the OECD text is being agreed with and incorporated and is weakest for cases where it is not clear whether the quotation is a sign of agreement. The Committee is currently seeking to ensure that where the commentary to the OECD text is cited it is clear whether the Committee agrees or disagrees with the interpretation (see E/2010/45, para. 14), so this last issue would probably only arise for parts of the United Nations Model Convention that have not been revised recently.

9. A conceptual basis for not including all specific observations, reservations and positions on the OECD Model Tax Convention, and one that perhaps raises the question of whether there is any need for observations, reservations and positions on the United Nations Model Convention, is that the Model Convention is a recommendation of a group of experts (the Committee) acting in their own capacity and is not intended to represent the formal views of Governments, even though it expresses the experts' knowledge of national practices and concerns. It does not, even in a "soft" sense, inhibit Governments in their negotiations and should not be seen as limiting their actions to negotiate the agreements suitable to them in particular circumstances. The certainty desired by investors and administrators can be facilitated by the United Nations Model Convention, which does not, however, constrain sovereign decisions.

10. As noted in paragraph 35 of its introduction, like all model conventions, the United Nations Model Convention is not enforceable. Its provisions are not binding and furthermore should not be construed as formal recommendations of the United Nations.

11. Although the option was not taken up by the Committee at its third session, a possible approach would be to include the following general comment in the introduction to the commentaries: "In citing the OECD Model Tax Convention on Income and on Capital (in its various versions) it is recognized that various OECD member States have expressed reservations on the articles of that text and made observations on the commentaries on the articles, and that some non-OECD member States have expressed positions on the articles and commentaries. Such formal expressions of differences from that Model Convention are contained in the text of

the OECD Model Tax Convention, as revised from time to time. The Committee notes that they are a useful aspect of the OECD Model Tax Convention in terms of understanding how it is applied and interpreted in practice, even though they have not been repeated in this Model Convention for practical reasons."

12. If country observations, reservations and positions are sought in relation to the United Nations Model Convention, States that feel strongly that such a general statement is insufficient could, of course, indicate a position on the Model Convention in so far as it cited the OECD Model Tax Convention in a particular case. This would more directly address the observations, reservations and positions expressed on the OECD Model Tax Convention although only to the extent that a particular interpretation had been picked up in the United Nations Model Convention, and where the way it was picked up did not sufficiently accommodate the concerns of States (such as by having an alternative formulation).

III. Observations, reservations and positions on the United Nations Model Convention

13. The approach outlined above raises the second aspect dealt with in this paper: the treatment of possible country observations, reservations and positions to the United Nations Model Convention itself (see para. 1 (b) above). The matter was also discussed by the Committee at its fourth session, in 2008 (see E/2008/45):

> 22. The possible value of countries making formal comments on the United Nations Model Convention was discussed, with general support for some such facility, including in terms of increased transparency in negotiating positions. One expert disagreed with that view. However, there was also some discussion on the need to differentiate between the terms "observations" and "reservations" used by OECD countries for the OECD Model Convention. A reference to non-binding "positions" or even "comments", it was noted, might be better. The need to keep any such task a manageable one in view of the Committee's resource constraints was also noted.

14. With regard to the above, achieving anything approaching a comprehensive database of country positions will involve a considerable amount of resources from the secretariat and, possibly, the Committee. Even if a subcommittee or working group were to be formed to deal with country positions, there would be a considerable amount of work involved in notifying all Member States, through the correct channels, of the possibility of including country positions, to follow up on States that do not respond and to liaise with potential responders, including with the Committee or a subcommittee. Attention would also have to be paid to ensure that responses: do not perpetuate misinterpretations of the United Nations Model Convention; are provided in a uniform way; and reflect an understanding of the process of recording country positions. It might be necessary to find a sponsor to address those resource issues, especially if a printed publication were proposed.

15. The process will take time and it should not, in the secretariat's view, hold up the completion of the 2011 update to the United Nations Model Convention. It should be undertaken as a distinct project, at least in this instance, in tandem with informing countries of the new version of the Model Convention and the capacity-building initiatives proposed by the Secretariat and referred to in the recent report of

the Secretary-General on the strengthening of institutional arrangements to promote international cooperation in tax matters (see E/2011/76, para. 17). It will be especially important to have as many developing country positions on the Model Convention as possible; this will not be easy to achieve in practice.

16. As indicated above, the reference to observations and reservations of countries has a particular meaning in OECD usage that does not exist for the United Nations Model Convention, which is why it is best to avoid the confusion that the use of such language might introduce. Assuming that positions or comments are called for, some States may be hesitant to respond if they believe that they may be perceived (including by local legislatures or courts) as binding themselves to certain positions in the future. In the introduction to the positions on the OECD text, it is noted that:

> 5. Whilst these economies generally agree with the text of the Articles of the Model Tax Convention and with the interpretations put forward in the Commentary, there are for each economy some areas of disagreement. For each Article of the Model Tax Convention, the positions that are presented in this section indicate where a country disagrees with the text of the Article and where it disagrees with an interpretation given in the Commentary in relation to the Article. As is the case with the observations and reservations of member countries, no reference is made to cases where an economy would like to supplement the text of an Article with provisions that do not conflict with the Article, especially if these provisions are offered as alternatives in the Commentary, or would like to put forward an interpretation that does not conflict with the Commentary.

17. It should be noted in that respect that China and Indonesia, in a footnote to the introduction, wished "to clarify expressly that in the course of negotiations with other countries, they will not be bound by their stated positions included in this section". The fact that the positions are not binding when it comes to States negotiating and interpreting treaties, including through their court systems, could be affirmed more explicitly in the United Nations Model Convention or any other document containing the positions. Likewise, it could be made clear that the positions taken by States should not prevent them from disagreeing with interpretations of the Model Convention not specifically discussed in the positions.

18. In order to adopt such an approach, it may be necessary to keep the list of positions up to date, even in between updates to the United Nations Model Convention, in order to take into account the positions of States that have not provided their positions before and modifications to existing positions. That is an additional reason why the collection of such positions should not be linked too closely to the publication of a new version of the Model Convention.

19. Moreover, in an article published in 2011, Brian Arnold noted:

> The discussions regarding Article 14 drew attention to a serious deficiency in the process for updating the United Nations Model, i.e. there is no opportunity for countries to make reservations on the articles of the United Nations Model or observations on the interpretation of those articles in the Commentaries on the United Nations Model, as is the case with the OECD Model. Reservations and observations are useful ways for minority positions to be recognized. As noted previously, the Committee is composed of experts serving in their personal capacities and not as country representatives. Accordingly, it would

be inappropriate for these experts to make reservations or observations and there is no mechanism for countries to make such resolutions or observations. The absence of a clear mechanism to recognize minority positions means that these positions are often reflected in the Commentaries on the United Nations Model and may, therefore, be accorded more weight than they deserve.[2]

20. The proposed approach would allow such minority positions at the country level to be recorded appropriately without necessarily being addressed in the commentaries. Some minority positions, especially those widely held among developing countries, would still be most appropriately noted in the commentaries (as occurs in the United Nations Model Convention). This would also allow country positions to be recorded in cases where they may not have been incorporated in the commentary by the members of the Committee because they were not identified or for other reasons.

IV. Recommendations

21. There could be advantages to having country positions attached to the United Nations Model Convention, in terms of transparency and the opportunity to have cleaner texts of the commentary, as well as in terms of instilling greater ownership in the Model Convention and making it possible to use the process to obtain feedback for future versions of the Convention and to achieve wider participation in the updating process.

22. There could also be disadvantages, including: in terms of the logistical issues involved in seeking and processing positions and then ensuring they are kept up to date in view of limited secretariat resources (a project that might be dependant on contributions from States or other entities); the need to have some coherence with regard to how positions are expressed and, probably, the need for dialogue before positions are finalized; the difficulty in taking sufficient advantage of the opportunity for positions to be put forward by the 193 States Members of the United Nations; and the risk that countries may feel they are unjustifiably "tying their hands" by putting their positions forward. Such advantages and disadvantages will need to be discussed by the Committee prior to a decision on this issue.

23. It is suggested that for the forthcoming updated version of the United Nations Model Convention:

(a) Country observations, reservations and positions on the OECD Model Tax Convention should, at most, be generally mentioned in the introduction to the Model Convention when the use of the OECD Model is addressed;

(b) The development of positions on the Model Convention should not delay its publication, but should, if embarked upon, be a separate but related process;

(c) References should be made to country positions, comments or the like, rather than to observations and reservations, in order to prevent confusion, especially given the way in which those words are used in relation to the OECD Model Tax Convention;

[2] Brian J. Arnold, "Tax treaty news", *Bulletin for International Taxation*, vol. 65, No. 3 (2011).

(d) Care should be taken in the language suggested to countries proposing a country position. The OECD Model Tax Convention usually follows the following format: "[country X] reserves the right". Whatever its appropriateness in the context of the OECD Model Tax Convention, language referring to countries "noting" or "pointing out" or "putting on record" would perhaps be better suited to the purpose of such a document, since the right to depart from the United Nations Model Convention is inherent and does not need to be stated formally, whether or not positions are stated on other provisions or aspects of the commentaries;

(e) It should be recognized that the speed with which a comprehensive list of positions can be produced and published will depend in part upon the willingness of donors to support such an effort.